



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Carl W. Mosher

SUBJECT: ANNUAL ADJUSTMENTS TO
RECYCLE PLUS AGREEMENTS

DATE: May 31, 2005

Approved /s/

Date 05/31/05

RECOMMENDATION

Accept this report clarifying the annual contractor compensation adjustment process in the Recycle Plus agreements.

BACKGROUND

This report is provided in response to questions in the 2005-2006 Proposed Operating Budget Study Sessions. Councilmember LeZotte requested information regarding the annual compensation adjustment process of the Recycle Plus agreements.

On March 27, 2001, the City Council approved agreements with GreenTeam of San Jose, Green Waste Recovery, and Norcal Waste Systems of San Jose for integrated waste management services. The contractors began providing service under these agreements on July 1, 2002.

ANALYSIS

As with most of the City's multi-year contracts, the Recycle Plus agreements allow annual compensation adjustments to account for changes in costs incurred by the contractor. The first of these adjustments was applied in FY 2003-04, increasing contractor compensation by approximately 3%. A second adjustment of approximately 3% was applied in FY 2004-05. The compensation adjustments will continue annually throughout the term of the agreements.

The "Contractor's Compensation" section of the Recycle Plus agreements stipulates that most service rates be adjusted each fiscal year, as indicated in the contract language below.

"At the start of the second year of this Agreement (July 1, 2003), and annually thereafter during the term of this Agreement as extended, the service rates set forth in [the section above] shall be increased or decreased by the percentage change in the Refuse Rate Index (RRI) from the base month, which shall be December of the prior

preceding year, to December of the immediately preceding year as contained in the most recent publication of the source documents listed in Exhibit 3 ("REFUSE RATE INDEX"), to this Agreement."

Contractor compensation accounts for approximately 74% of total Recycle Plus program expenditures. Consequently, compensation adjustments based on increases in this category can significantly impact customer rates. Other expenditure categories include landfill disposal and administrative costs such as program management, billing and customer service.

Each Recycle Plus contractor is required to submit operating cost statements annually that detail collection expenditures (processing costs excluded). These then are used in conjunction with the Refuse Rate Index (RRI) for each agreement. The RRI was developed in consultation with representatives from R.W. Beck, a leading solid waste consulting firm. The RRI is designed to accurately reflect annual changes to contractor expenditures. Rather than relying on a single index (such as the Consumer Price Index) to make annual contract adjustments, the RRI uses five indices published by the U.S. Bureau of Labor Statistics (BLS). These indices reflect national cost changes for labor, diesel fuel, biodiesel fuel, vehicle replacement and vehicle maintenance, and for other miscellaneous costs.

A detailed discussion of the process used to determine compensation adjustments in conjunction with the RRI is presented in Attachment A, which includes Tables 1 and 2. Key aspects, however, is the larger allocation for vehicle replacement for Norcal (18.59%), which purchased nine trucks during the year, and the 38% increase in the cost of diesel fuel. As a result, the 5.80% average RRI adjustment for FY 2005-06 for the four contractors is higher than the previous average adjustments of 3.20% in FY 2004-05 and 3.18% in FY 2003-04.

CONCLUSION

It is estimated that Recycle Plus contract costs will increase between 4.8% and 6.7% in FY 2005-06, depending on the particular contract and the final data provided by BLS. Modest rate increases of 3% for single-family and 2% for multi-family customers are recommended to help offset these increased contract expenditures.

COORDINATION

This MBA has been coordinated with the City Manager's Budget Office and the City Attorney's Office.

/s/
CARL W. MOSHER
Director, Environmental Services Department

ATTACHMENT A

Calculating Compensation Adjustments

The amount of the annual adjustment is determined by first calculating the Refuse Rate Index (RRI) for each agreement. Based on the annual contractor statements, a weighting is determined for each of the BLS indices. For example, if 20% of the contractor's annual expenditures are allocated to labor costs, the change in the BLS labor index will be weighted to provide 20% of the overall contract adjustment. Because the breakdown of expenses differs every year for each agreement, the weighting for each index will differ from contract to contract. Consequently, the annual RRI adjustment is unique for each of the Recycle Plus agreements. A breakdown of the cost allocations for each of the Recycle Plus agreements for the FY 2005-06 adjustment is detailed in Table 1.

TABLE 1 – CONTRACTOR EXPENDITURE ALLOCATIONS FOR FY 2005-06

Category	GreenTeam SFD/MFD	Green Waste YT	Norcal SFD	Norcal YT
Labor	43.62%	48.66%	42.83%	46.36%
Fuel - Diesel	3.51%	3.44%	6.04%	6.80%
Fuel - Biodiesel	1.68%	3.58%	NA	NA
Vehicle Replacement	3.70%	9.87%	18.59%	11.93%
Vehicle Maintenance	4.64%	2.15%	4.10%	4.58%
Misc. Expenses [*]	42.85%	32.29%	28.45%	30.32%

^{*}Miscellaneous expenses can include, but are not limited to, rent on property, truck licenses or permits, taxes, utilities, safety equipment, uniforms, insurance (including employee group medical and life), general yard repairs and maintenance, postage, advertising, and employee retirement or profit sharing contributions.

The expenditure allocation percentages shown above are then applied to changes in indices published by BLS. Table 2 below lists the changes in BLS indices used to calculate the FY 2005-06 adjustments, as well as the calculated weighted index changes for each contract. The weighted index changes are calculated by multiplying the BLS index change by the weightings listed above in Table 1.

For example, to determine GreenTeam's weighted labor index change, the 3.29% index change is multiplied by the weighting of 43.62%, for a weighted change of 1.44%. To determine the final Refuse Rate Index, the weighted index changes are added together. In the GreenTeam example, the overall increase for FY 2005-06 is 4.81%. The RRI is then applied to the compensation schedule of each agreement for the annual fiscal year adjustment.

**TABLE 2 –BLS INDEX CHANGES AND CONTRACTOR
 WEIGHTED INDEX CHANGES FOR FISCAL YEAR 2005-06**

Category	BLS Data	Weighted Index Change			
	Change In Index	Green Team SFD/MFD	Green Waste YT	Norcal SFD	Norcal YT
Labor	3.29%	1.44%	1.60%	1.41%	1.52%
Fuel - Diesel	37.92%	1.33%	1.31%	2.29%	2.58%
Fuel - Biodiesel	3.26%	0.05%	0.12%	NA	NA
Vehicle Replacement	10.07%	0.37%	0.99%	1.87%	1.20%
Vehicle Maintenance	4.76%	0.22%	0.10%	0.19%	0.22%
Misc. Expenses	3.26%	1.40%	1.05%	0.93%	0.99%
Overall Increase (RRI)	NA	4.81%	5.17%	6.69%	6.51%

The average adjustment for the four contractors totals 5.80% for FY 2005-06, larger than the previous two years. Note the 38% increase in diesel fuel costs and, in Table 1 above, the 18.5% cost allocation for vehicle replacement by Norcal – the main contributing factors.